No. 85-599

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA,

Petitioner

v.

AMERICAN BAR ENDOWMENT,
FREDERICK D. TURNER *et ux.*,
ARTHUR M. SHERWOOD *et ux.*,
FREDERICK G. BOYNTON and
HERBERT C. BROADFOOT, II *et ux.*,

Respondents

On Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

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BRIEF FOR RESPONDENTS

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QUESTIONS PRESENTED

1. Whether policyholder dividends in a group insurance program that are assigned to the American Bar Endowment by its insured members in a charitable fundraising program constitute income from an unrelated trade or business?

2. Whether the Federal Circuit correctly remanded the cases of the four individual insureds to the Claims Court for a determination of whether a charitable contribution deduction for the assignment of such dividends was appropriate in light of "all the pertinent circumstances" involving the relationship between the four insured members and the Endowment, including the motivation and intent of each individual claiming a charitable deduction?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Table of Authorities Continued

Table of Authorities Continued

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BRIEF FOR RESPONDENTS

RULE 28.1 STATEMENT

Reference is made to the Endowment's Rule 28.1 Statement in its Brief in Opposition. There are no changes in that statement.

STATEMENT OF THE CASE

The Government did not challenge the factual findings of the Claims Court in the Federal Circuit, and the Federal Circuit specifically affirmed the findings of the Claims Court. (Pet. App. 2a-9a) Yet the Government is in effect asking this Court to reverse Chief Judge Kozinski's findings of fact, entered after a month's trial involving 23 witnesses and hundreds of exhibits. *See* Rule 34.1.(g). Thus, the following statement of facts is essential to an understanding of this case and the issues before the Court.

A. The Facts

The Endowment's Program

The Endowment is a section 501(c)(3) membership organization, the charitable purpose of which is to make grants to fund legal research and education for the advancement of the administration of justice and the science of jurisprudence. (Pet. App. 2a, 26a; JA 72; CA App. 906-13 at 907, JA 124, 125) All members in good standing of the American Bar Association ("ABA") are members of the Endowment ("ABE"). (Pet. App. 2a, 26a; JA 72) In the 1950's, the Endowment, at the suggestion of the ABA, developed a charitable fundraising plan through a group life insurance program for ABE members that was designed to generate sufficient contributions to enable the ABE to further its charitable objectives. (Pet. App. 26a-27a; JA 73-75) As an integral feature of the charitable fundraising plan and as a condition for participating in the program, members agreed on the insurance application to assign their proportionate share of policyholder dividends as contributions to the

Endowment. (Pet. App. 3a, 32a; JA 76, 78, 82, 121-22, 293-94) Each year the Endowment informed its members of "what percentage of the total premiums had been refunded and used for charitable purposes," so that members could, if they chose, claim a charitable contribution deduction. (Pet. App. 33a; JA 82-83, 232-34; CA App. 855-92, 1205)[1]

The insurance offered through the Endowment's program is professional association group insurance—now a common concept, but a new one in 1955. (Pet. App. 35a; JA 156, 159-60) Under such an arrangement the association serves as the group policyholder. One or more insurance companies underwrite the plans of insurance, and there may be a broker or agent of record. The administration of the insurance program is accomplished by the association and/or by a third party administrator or sometimes by the insurance company. (JA 166-67, 211-12) During the years in issue, New York Life and Mutual of Omaha were the insurers for the Endowment's life and accident and health insurance programs, respectively, and the Endowment purchased the policies through a licensed insurance broker (James Group Service, Inc.) which received a negotiated commission from the insurance companies for its services. (Pet. App. 3a-

[1] That amount equalled a member's attributable portion of the dividends received by the Endowment minus the Endowment's cost of administering the insurance program. (JA 83, 90-91; CA App. 893-905, Trial Tr. 1891) Since the Endowment does not have the economies of scale that a professional administrator has, the Endowment's cost of administration exceeds the commercial charge for such services. *See infra*, pp. 26-28. The Endowment's practice of notifying members of the amount of their contributions began in 1964. (JA 234)

4a, 27a) The Endowment administered the programs. (Pet. App. 4a)

Other professional association group plans are designed to provide low cost group insurance as a service to members and have no charitable feature. Policyholder dividends paid by the insurance company normally are returned to participating association members either in the form of a cash distribution or a credit toward future premiums. (Pet. App. 38a, JA 168, 175-76) The Endowment's plan, however, is different from other professional association plans—the dividends on the Endowment's group policies are assigned to it by its members for charitable purposes in the field of law. (Pet. App. 32a-33a, 36a-41a) The program produces an "astounding proportion of its gross premiums recouped as dividends." (Pet. App. 8a)[2]

The dividends are produced by two factors. First, the Endowment's group policies are experience-rated—*i.e.*, the portion of premiums actually retained by the carrier to cover the cost of providing insurance coverage is based on the mortality and morbidity experience of *this group* rather than on a standard actuarial table applicable to the population as a whole. (Pet. App. 29a-31a; JA 326-28, 358-62)[3] The Claims

[2] For example, in the Endowment's fiscal year 1979, 47 percent of the group life insurance premiums were returned to the Endowment as dividends for a total of $3,466,830. (CA App. 893-96 at 895, Trial Tr. 1891) For the Endowment's fiscal years 1980 and 1981, the life program percentages were 55 percent and 65 percent, respectively. (JA 78)

[3] Such experience-rated policies are not unique to the Endowment. For example, New York Life, a mutual insurance company, offers experience-rated plans and pays dividends to its other association group policyholders. These policyholders use the dividends for the economic benefit of their members. (JA 175-76, 184-85) Thus, the "net cost" of insurance to members of other professional associations is very low when compared to the Endowment's plan. *See infra*, p. 9 n.5 and p. 11 n.7.

Court found that the 300,000 members of the ABA as a whole have "a very favorable mortality and morbidity rating" which is "a valuable asset" belonging to the group. (Pet. App. 38a; JA 501-02) Second, the gross premiums on the Endowment's insurance program are set intentionally at significantly higher levels than necessary, and "premiums could have been set much, much lower if maximizing participation had been the principal objective." (Pet. App. 28a-29a; JA 158, 160, 182, 190-91, 205, 217-18, 291-92, 341-42, 413)

The Claims Court found that the significant policyholder dividends generated by the interaction of these two factors explicitly reflected the charitable fundraising strategy of ABE *and the wishes and expectations of the ABE membership*. (Pet. App. 35a-41a, JA 505) Participating ABE members knowingly pay premiums much higher than necessary (often twice as much as is necessary) for insurance coverage than they would under a plan without a charitable feature. (Pet. App. 32a-33a, 37a-39a) Instead of pocketing the resulting policyholder dividends themselves as other professionals do, ABE members assign the dividends to the Endowment to be utilized (after the expenses of administering the plan are deducted) for charitable grants in the field of law. (Pet. App. 32a-33a, 36a-40a) The Claims Court found that "the program was devised as a means for fundraising and has

been so presented and perceived from its inception," further stating that the Endowment has "stubbornly adhered to the original concept that its plans are exclusively for fundraising." (Pet. App. 35a-36a; JA 73-75, 123-24, 144-45, 156, 157-58, 291-92)

The ABE insurance program is today and has been at all relevant times an innovative and successful charitable fundraising plan strongly supported by the ABE membership. (Pet. App. 35a-41a; JA 118, 125-26, 146-47, 155-56) From rather modest beginnings in 1955, this charitable fundraising program has expanded over the years to include the participation of tens of thousands of ABE members and has generated tens of millions of dollars in contributions by insured members. (Pet. App. 4a, 27a; JA 72, 93) Those contributions have been the source of grants totaling over $63 million to such recipients as the American Bar Foundation, the ABA Fund for Public Education, the Institute for Judicial Administration, the Institute for Court Management, the National College of District Attorneys, the National Council of Juvenile and Family Court Judges, the National College of Criminal Defense Lawyers, the National Institute for Trial Advocacy, and the National Legal Aid and Defender Association. (JA 72)[4]

[4] In its fiscal years 1979, 1980 and 1981, the Endowment made grants for a wide variety of projects totaling $3,602,462, $4,397,619, and $4,640,000, respectively. (JA 72) For example, the Endowment's report to its members for fiscal year 1980, published in the ABA Journal, indicates that among the projects fully or partially funded in that year were the publication of the second edition of the American Bar Association Standards of Criminal Justice, a reassessment of state medical practice acts as they pertained to the providers of health care services, an examination of sentencing guidelines to obtain greater uniformity, an ABA project on victim/witness assistance, the ABA Action Commission to Reduce Court Costs and Delays, the minority bar leaders conference, legal assistance to the poor programs sponsored by the National Legal Aid and Defender Association and a training program of the National College of Criminal Defense Lawyers and Public Defenders. (CA App. 984-87, Trial Tr. 1894)

The Endowment did not function either as an insurer or as a broker. Rejecting the Government's position that the Endowment "sells insurance at fair market retail prices" (Br. 15), the Claims Court found that the Endowment does not buy and sell insurance. It receives no payments from the insurance carriers for services rendered. (Pet. App. 27a, 47a) The Claims Court rejected the Government's contention to the contrary:

> All of the evidence on both sides makes it clear that the money here came from premiums, that no matter what the flow of dollars the economic reality was that these were the members paying money to the association and not insurance companies paying the group in some fashion. (JA 508)

The Claims Court also expressly found as a matter of fact that the dividends were not compensation paid to the Endowment, either by the insurance companies or by the insured members. (Pet. App. 27a, 39a-41a; JA 440) Based on all of the evidence at trial, the Claims Court found that—

> [t]he amount of money ABE is permitted to retain far exceeds the value of any service it may be providing through the operation of the insurance programs. It is quite obvious,

> then, that this money was not earned "from the sale of goods or the performance of services," 26 U.S.C. § 513(c) (1976), but for some other reason. *That reason was the intent of the members to support the Endowment's charitable activities.* (Pet. App. 41a) (Emphasis added.)

The Government did not challenge these or other findings of fact in the Federal Circuit. Even so, the Federal Circuit reviewed the evidence of record and confirmed the findings of the Claims Court, remarking that "the Claims Court specifically and permissibly rejected the Government's contention that the dividends represent a payment for the Endowment's services." (Pet. App. 11a)

The Claims Court considered the Government's view before this Court that the Endowment "deals with its members, *in their capacity as customers*, in a business-like manner and at arm's length," treating "its market, in short, much as other profit-maximizing enterprises treat theirs" (Br. 37) and rejected it. That court found that "both the ABE leadership and the insured members considered the insurance program a fundraising activity and treated it as such," noting that even the two ABE members who testified for the Government understood that the insurance program was a charitable fundraising activity. (Pet. App. 36a & n.5; JA 122-27, 143-48, 196-97, 295-96, 393, 448-49, 450-51, 454) Furthermore, the Claims Court explicitly found that ABE members were fully and fairly informed in a variety of ways as to the charitable purposes of the insurance program:

> [The Endowment] disclosed the relevant facts to its members at every available opportunity, yet the members (who bore the economic cost of this program) allowed the practice to continue although they collectively had the power to change it.

(Pet. App. 40a; JA 223-34, 324, 344-45, 405, 504-05; CA App. 1196-1204; JA 226-28)

ABA/ABE members could have determined to retain the benefit of their favorable mortality and morbidity experience for themselves.[5] The Court found, however, that ABA/ABE members affirmatively chose not to pursue this course:

> If the ABA had chosen to do this, it could have offered its members insurance at premiums lower than any other bar association, perhaps the lowest premiums of any group in the country. *The ABA members, however, have chosen a more generous approach*, allowing the Endowment (rather than the ABA) to operate the insurance program and retain the dividends. (Pet. App. 38a) (Emphasis added.)

In addition to the substantial financial sacrifice of those who actually purchased insurance, Chief Judge

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[5] "Most professional associations (including almost all bar associations) operate such programs on a service-oriented basis and secure the most economical group insurance for their members." (Pet. App. 38a. *See* JA 144-45, 159-60, 316, 326) Specifically, the Court found that such a program could have been operated at the same "net cost" as the Endowment's program: "The money that could have been saved by the members who bought insurance was equal to the dividends refunded minus the Endowment's operating expenses. This amounted to several million dollars a year." (Pet. App. 38a n.5; JA 159, 162-63, 218, 330-31, 363-64)

Kozinski observed that the program was "very costly" to those ABA/ABE members who did not buy insurance but allowed the program to continue as a charitable one, thereby denying themselves the opportunity to participate in a low-cost, service-oriented group insurance program. (Pet. App. 38a) Each ABA/ABE member "made a contribution in an economic sense." (JA 503-05)

The Government urged at trial that ABA/ABE members had "no control over the way the insurance programs are operated because the programs are maintained in their present form by an unresponsive leadership" (Pet. App. 39a) and now (as though it had prevailed on that point) urges that change could be effected only by a "grass roots" movement to "oust the current leadership." (Br. 12, 36-39, 45-46) However, Chief Judge Kozinski specifically found to the contrary, holding that there was "nothing" in the record to suggest that the ABA/ABE leadership was unresponsive to the members; the insurance program was "operated with the approval and consent of the ABA membership." (Pet. App. 38a-39a) The Claims Court also found that the attitude of the ABA/ABE leadership toward the program reflected the views of the membership and that, if the members had wanted to discontinue the charitable feature and either lower insurance rates or retain the dividends for themselves, the leadership would have responded by implementing those wishes:

> Plaintiff has demonstrated to the court's satisfaction that there are ample, effective channels within the APA for members to make their views known *and have them implemented.*

(Pet. App. 39a-40a & n.9) (Emphasis added.)[6]

The Claims Court specifically addressed what appears to be the factual predicate for the Government's argument in this Court—that the gross premiums paid by Endowment members "were within the competitive range of the market." (Pet. App. 41a) In disagreeing with the Government's legal argument on this point, Chief Judge Kozinski also noted that the Government had not proved its factual case:

> The record does not, in any case, fully support defendant's factual contention. As will be discussed more fully below . . . , it is impossible to isolate a single market for insurance. The cost of insurance depends on a variety of factors, many of them individual to each buyer. Thus, while ABE insurance may have been within the competitive range for some potential buyers it was not for others. (Pet. App. 41a n.10)[7]

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[6] Wm. Reece Smith, Jr., a former President of the ABA and of the Endowment, testified at length concerning the governance of the ABA and ABE. (JA 131-40) He and other ABA and ABE leaders noted the lack of dissent within the ABA concerning its support of the Endowment's program. (JA 125-26, 145-48) The Court accepted this testimony. (Pet. App. 38a-39a)

[7] The correctness of this finding is illustrated by reference to the prices charged for participation in the New York State Bar life insurance plan. This was the only plan that the trial court found (after minor adjustments) comparable to the life coverage available through the Endowment from New York Life. (Pet. App. 55a & n.17) The net cost (after dividend credits) of participating in the New York plan is lower than the ABE gross premium payments by approximately the amount of the contributions to charity under the ABE plan. This result was disclosed

The Government did not challenge this finding below; it simply asserts the contrary to this Court.

The Claims Court viewed comparison of rates between group insurance and individual insurance as "inherently misleading" (JA 512), observing that there are many factors that need to be considered in valuing a particular insurance policy. (Pet. App. 50a-52a) The Claims Court also observed (JA 511-12) that the Government's suggestion that insurance was capable of valuation in one market was—

> simply not supported by this record. I think it is utter nonsense. I think there are at least 50 markets for insurance, particularly group insurance. I think one ought to take into account the basic and significant differences between group insurance and individual insurance. I think individual insurance by clearly established record is a different product and a significantly different product.

The Individual Respondents

The brief testimony of Messrs. Boynton, Broadfoot, Sherwood and Turner in support of a charitable contribution deduction must be read in the context of *all* of the testimony at trial in these consolidated cases concerning the relationship of the Endowment members to the insurance program. Each individual insured knowingly participated in the group insurance program operated by the Endowment to raise funds for its charitable purposes. (Pet. App. 38a-39a, 54a-

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by the comparative figures presented by the Government's expert actuary (JA 445-47) and recognized by the Claims Court. (Pet. App. 55a)

56a) When each enrolled, he reviewed Endowment literature explaining that dividends would be assigned to the Endowment and utilized for charitable purposes; he signed a statement agreeing and acknowledging that the dividends would be paid to the Endowment. Each plaintiff received the annual notices which the Endowment mailed to its insured members advising of the percentage of his initial premium for the prior year that was considered to be a charitable contribution to the Endowment. Each testified that his checks to the Endowment for semiannual premium payments were written with the knowledge that a substantial portion of the amount paid would be a contribution to the Endowment for its work in the field of law. (JA 82-83, 232-34, 260-63, 271-74, 277-79, 282-84; CA App. 855-92, 1205)

B. Proceedings Below

On November 11, 1983, the Claims Court delivered a lengthy oral opinion, deciding the unrelated business income case in favor of the Endowment, concluding on the basis of the facts proved at trial that the insurance plan of the Endowment "is not a business" and that the Endowment "is not making a profit from its enterprise." (JA 498-518) Chief Judge Kozinski declined to decide the charitable contribution question at that time because he had "grave doubts" and "I am not going to be able to resolve them today." (JA 510)

Judge Kozinski decided the charitable contribution issue on December 21, 1983. While he recognized the validity for charitable contribution purposes of a dual payment made to obtain both an economic good and a charitable contribution (JA 522; *see* Pet. App. 49a) and acknowledged that Endowment members should

be entitled to make a showing that they made a charitable contribution (JA 539), the court ruled against the four respondents. (*See* JA 518-40) Chief Judge Kozinski rejected respondents' effort to infer from the "group gift" a charitable motivation applicable to all insured members and held that a charitable deduction would be available on a case-by-case basis if the member demonstrated a charitable motivation by showing that an equivalent insurance product was available to him for a lower price and that he knowingly bypassed that product in order to make a contribution to the Endowment. (Pet. App. 52a; JA 522)

The two oral opinions were followed by a written opinion directed to all five cases. (Pet. App. 25a-56a)

The Federal Circuit affirmed the conclusion of the Claims Court in the ABE's case, observing that "the Claims Court specifically and permissibly rejected the Government's contention that the dividends represent a payment for the Endowment's services" (Pet. App. 11a) and agreed with the Claims Court's conclusion that the Endowment's insurance program did not meet the statutory definition of a trade or business. The court observed that a charity "should not be subject to taxation merely because its charitable solicitations are successful. This would, however, be the result if we adopted the IRS' reasoning in this case." (Pet. App. 12a)

Turning to the charitable contribution issue, the Federal Circuit declined to approve the uniform rule urged by respondents (Pet. App. 21a n.9) and also rejected the "single-factor test" of charitable motivation designed by the trial court. (Pet. App. 19a-23a) It held that "well established principles of tax law from this circuit and elsewhere require that we

reject the unitary approach of the court below and remand for consideration in accordance with those principles as they should be applied to this unique situation." (Pet. App. 15a) The Federal Circuit observed that the Claims Court test improperly required the taxpayer to "prove a charitable motivation of disinterested generosity," failed to "take into account the fact, that, in other plans, the participants are entitled to their dividends", and was based on a false assumption that "all participants are purely 'economic' persons, acting solely on a careful and detailed comparative investigation of pecuniary results and expectations." (Pet. App. 20a) The court then discussed circumstances which would tend to show whether an insured member was charitably motivated or not, and remanded for further proceedings to consider whether "the transaction between the Endowment and the taxpayers involving the assignment of dividends 'was of a business nature and not charitable.'" (Pet. App. 21a-22a)

SUMMARY OF ARGUMENT

The Endowment's Case

All this case is "about" is the decision of the members of a professional association to dedicate millions of dollars to charity that they could keep for themselves without any tax consequences to any person. The Claims Court and the Federal Circuit found that dividends assigned by insured members to the Endowment were received by the Endowment as the consequence of a long-standing charitable fundraising program approved of and controlled by the Endowment's membership. They were not attributable to the

conduct of a trade or business and were not derived from the sale of goods or the performance of services.

The findings upon which the conclusions of the lower courts rest are overwhelming. They include the following:

> This is not a business and is not making a profit from its enterprise. (Pet. App. 11a-12a, 41a; JA 498)
>
> This was a charitable fundraising program about which the membership was well informed. (Pet. App. 35a-36a)
>
> This perception has been held by many thousands of people for the better part of three decades. (*Id.* 36a)
>
> It was not operated in a competitive manner. (*Id.* 34a-35a)
>
> The insurance program was operated with the approval and consent of the membership. (*Id.* 38a-39a)
>
> The program was maintained in its present charitable form by leadership responsive to the wishes of the members. (*Id.* 39a)
>
> There are ample, effective channels for members to make their views known and have them implemented. (*Id.* 39a-40a)
>
> The excellent mortality and morbidity rating of the members represented a valuable "group asset" which was generously assigned to charity. (*Id.* 31a, 38a; JA 501, 503, 509)
>
> The ABA/ABE members as a group have permitted the Endowment to collect exorbitant revenues when they could easily deny it any and secure for themselves service-oriented group insurance at much lower cost whenever they so desired. (Pet. App. 42a; JA 503)
>
> The huge sums raised by the Endowment were wholly unrelated to the value of services provided by the Endowment. (Pet. App. 40a)
>
> The members would have been subject to an epidemic of irrationality to have permitted such huge charges in a commercial venture: the far more reasonable explanation is that they supported it because they considered it charitable fundraising. (*Id.* 41a)
>
> It is quite obvious that the Endowment's net revenues were not earned "from the sale of goods or the performance of services" but were due to the generosity of the members (*id.* 38a) and their intent to support the Endowment's charitable activities. (*Id.* 41a)
>
> There was no identifiable business over which the ABE was able to gain an unfair advantage. (*Id.* 48a; JA 507)
>
> Taking these facts together, the ABE's activities were not commercial and therefore not a business. (Pet. App. 40a, 48a)

Rule 52(a) of the Federal Rules of Civil Procedure provides that findings of fact shall not be set aside unless found to be "clearly erroneous," with due regard being given to the trial court's opportunity to assess the credibility of the witnesses. The "clearly

erroneous" standard is not limited to subsidiary facts but applies as well to ultimate facts and findings. *Pullman-Standard v. Swint*, 456 U.S. 273, 287 (1982). The rule has been found especially useful in this Court with respect to cases which, like the present one, involve a lengthy trial record, with numerous witnesses and documentary evidence, that has already been fully reviewed and considered by two lower courts. *See Rogers v. Lodge*, 458 U.S. 613, 622-23 (1982), and cases cited therein. The Claims Court's findings of fact, which were specifically endorsed by the Federal Circuit, are conclusive on the question of whether the Endowment had unrelated business income.

The conclusion of the courts below that the amounts in question here do not constitute unrelated business income is consistent with the purpose of the statute as well as its language. Section 513(c) taxes income received from "any activity which is carried on for the production of income from the sale of goods or the performance of services." It is undisputed that the "primary purpose" in enacting the statute in 1950 was to put the business operations of tax-exempt organizations on an equal footing with those of their taxpaying counterparts. The Claims Court and the Federal Circuit found both that the amounts in question were not received from the conduct of a trade or business and that the Endowment was not in competition with any taxpaying entity.

The Government admits that a professional association group policyholder conducting an insurance program in precisely the manner in which the Endowment has conducted this program is not engaged in a trade or business if it offers to return to insured

members the excess of dividends over expenses. Yet the Government would tax the Endowment, apparently not because of its activities, but because the Endowment restricts its program to members who have agreed in advance to assign their dividends for charitable purposes. The Government's purported distinction relates only to the form of the gift by members and refuses to recognize its reality.

The trade association cases relied upon by the Government are based on findings that the dollars there in question were paid to business leagues by insurance companies *in exchange for* the performance of services. The legal question addressed by those courts—whether earnings from these services did not constitute "business" income because the associations allegedly lacked "profit" motive—does not arise in the Endowment's case because the Claims Court and the Federal Circuit in this case found that the assigned dividends retained by the Endowment were not attributable to the sale of goods or the performance of services.

The Government's contention that the Endowment bought insurance at "wholesale" and sold it at "retail" ignores the findings of the Claims Court. The Claims Court found that the members of the Endowment do *not* pay the Endowment as "profit" twice as much as they need to pay for insurance, specifically declining to find that ABA members are so gullible.

Nor will some tax loophole be opened if the Federal Circuit decision is affirmed. As to the Endowment, the tax consequences are the same as those in other professional association group plans where the associations perform administrative services but return dividends net of expenses to their members; the group

policyholder is not taxed for playing that role. The ABE members who have assigned their dividends to the Endowment for charitable purposes will receive a deduction as would members of other professional associations who decided to dedicate their dividends to charity.

The Individual Taxpayers' Cases

The Government acknowledges the validity of the "dual payment" concept, whereby a single payment to charity may generate a charitable contribution deduction where the transferor intended to make a charitable contribution and received in return a benefit whose fair market value is not commensurate with the amount of the transfer. The Endowment members made a dual payment. Whether one looks at the fair market value of services rendered by the Endowment or the fair market value of the association group insurance received by the members or looks at a combination of both, the insured members have paid grossly excessive amounts for what they have received in return. The members of the Endowment, acting collectively and in a spirit of generosity, denied themselves the low cost insurance coverage enjoyed by other professional associations. The amounts paid to charity add nothing to the fair market value of the economic benefits received by the insured members. An insured member should be entitled to demonstrate his intention to make a contribution. The Federal Circuit, in remanding for further proceedings, applied traditional principles of tax law that do not conflict with any decided cases. The Government in its brief does not identify any issue for this Court to

resolve with respect to the cases of Messrs. Boynton, Broadfoot, Sherwood and Turner.

ARGUMENT

I. The Policyholder Dividends Assigned To The Endowment By Insured Members Are Derived From A Charitable Fundraising Program And Are Not "Income" From A Trade Or Business.

A. The Record Below and the Concessions of the Government Require Affirmance.

The Government would tax "policy dividends or retrospective rate credits that accrue to the group policies." (Br. 4) Policy dividends, however, are nothing more than a reduction in the amount of premiums paid. *Estate of Jordahl v. Commissioner*, 65 T.C. 92, 99 (1975). (Br. 4) In recognition that policy dividends are a return of a premium overcharge, as a rule they are not taxed to the recipient. Yet the Government here would tax the policy dividends as gross income to the Endowment, although the Government would not tax the same amounts, either to the Endowment or to the insureds, if the Endowment had engaged in precisely the same activities it did in administering the group insurance program, but had merely offered to return those amounts to insured members upon their request. *See* G.C.M. 38955 (June 29, 1982), *reprinted in* [1982-1983 Transfer Binder] IRS Positions Rep. (CCH) ¶ 1157.

In its Brief, the Government concedes that—

> [i]f the Endowment had instead consented to rebate the dividends to its members, coupling such rebates with a request that the members voluntarily contribute the dividends back to

> it, it would have a strong claim that funds thus contributed were *derived "from" charitable solicitations* rather than "from" its insurance business. (Emphasis added.)

(Br. 24-25. *See also* Br. 37.) In offering this concession the Government fails to note that both courts below found that "funds thus contributed" by insured members *in fact* were "derived 'from' charitable solicitations" and were *not* derived by the Endowment "from" an "insurance business."

The Federal Circuit captured precisely the fallacy in the Government's position when tested by the record in this case. The Federal Circuit observed (Pet. App. 12a n.6):

> On the conclusion reached below, which we accept, our refusal to view the recouped dividends as payment for the Endowment's services is consistent with the IRS' own memoranda. In G.C.M. 38940 [which concerned the Endowment's case] . . . the IRS stated that a group policy holder such as the Endowment "serves as group policyholder *in exchange for which* the individual insured members agree to pay premiums and irrevocably assign their share of the premium refunds." (Emphasis in original.) In G.C.M. 38955 . . . the IRS stated that a similar plan did not subject a charitable organization to taxation if it offered to distribute the dividends to those participants who so requested. The IRS concluded that the offer of a rebate negated the presumption that the dividend was consideration for the organization's services. *In the present case, the Claims Court specifically found that the assignment of dividends was not an exchange for services, but rather reflected the intention of the membership to support the Endowment's charitable activities. This case therefore falls within the rule of G.C.M. 38955, rather than G.C.M. 38940.* In any event, we fail to see how one plan competes any less with commercial group insurance plans than the other. If any difference exists, the plan which offers to distribute the dividends presents the greater possibility of competition with taxed organizations. (Emphasis added.)

There is no distinction in principle or, as found by the Claims Court and the Federal Circuit, in fact, between the *continuing decision* of the Endowment members to assign each year's dividend for charitable uses and an *annual decision* to give an attributable portion of that year's dividend to charity, except that the Endowment's plan is wholly charitable and the other is only partially so. The form of the program hardly turns charitable contributions into unrelated business income.[8]

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[8] As the Claims Court noted (Pet. App. 46a), the Internal Revenue Service on two occasions (1972 and 1973) ruled that the dividends received and retained by the Endowment did *not* constitute unrelated business income. The Court observed:

> It is also not without significance that for 21 years the Internal Revenue Service took the position that ABE's operation of the insurance program was not taxable. *See* IRS Letter Ruling 8042012 (July 3, 1980) (citing unpublished technical advice memorandum of January 31, 1973, that concluded ABE's insurance program was not a business). This suggests that whatever UBIT policies the ABE's activities are thought to implicate must be subtle indeed.

B. The Federal Circuit Applied the Statutory Standard Correctly.

The Endowment can be taxed only to the extent it realizes "unrelated business taxable income," which in pertinent part is defined by section 512(a)(1) of the Internal Revenue Code of 1954 (as amended) as—

> the gross income derived by any organization from any unrelated trade or business (as defined in section 513) . . . less the deductions allowed . . . .

(Pet. App. 63a) A "trade or business" is defined by section 513(c) as "any activity which is carried on for the production of income *from the sale of goods or the performance of services.*" (Pet. App. 67a) (Emphasis added.)

The Government asserts that the Endowment's "insurance activities obviously comprise both 'the sale of goods' and the 'performance of services,' " and argues that the dividends were compensation received by the Endowment from the insurance carriers and its insured members for such goods or services. (Br. 23) In doing so, the Government pretends that a trial did not take place and tries to erase from the record the unequivocal findings of both the Claims Court and the Federal Circuit that the dividends received and retained by the Endowment were *not* income from the sale of goods or the performance of services. (*See* Pet. App. 9a-12a, 35a-41a and *supra*, pp. 7-10, 16-17.)

In addition to applying the plain language of the statute, the Claims Court properly analyzed the Endowment's activities taken as a whole, concluding that the Endowment "is not a business and is not making

a profit from its enterprise." (JA 498; Pet. App. 33a-41a) In testing the Endowment's program against the statutory standard, the Claims Court held that an integrated analysis of the Endowment's program made it "impossible to conclude that the insurance programs were operated by ABE in a competitive, commercial manner." (Pet. App. 40a) *See* Pet. App. 8a-12a and *Disabled American Veterans v. United States*, 650 F.2d 1178, 1185-87 (Ct. Cl. 1981), *aff'd*, 704 F.2d 1570 (Fed. Cir. 1983).

Taken as a whole, the Claims Court's analysis reveals the following: (1) Endowment members paid far more than necessary for group insurance coverage, including all services related thereto;[9] (2) they knew that they were paying far more than necessary; (3) they intended to pay more than necessary in order to support the charitable purposes of the Endowment; (4) they had the power at any time to pay much less, but chose not to exercise that power; (5) the Endowment program was responsive to their wishes, attributable to their generosity, and represented their choice and intent to dedicate tens of millions of dollars to charity rather than returning them to their own pockets; (6) the Endowment does not compete with anyone, but rather serves as a group policyholder, administering its five group insurance policies only for its own members; (7) the Endowment's expenses exceed the fair market value of its services;

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[9] The Government does not discuss the fact that profiting on services to members was against the policy and practice of the ABA. Former ABA President Wm. Reece Smith, Jr. testified: "To my knowledge the ABA has never sought to make a profit on any services which it renders on behalf of the membership of the Association." (JA 141)

and (8) the insurance itself is provided by commercial insurance companies which earn a taxable profit, and which pay a taxable commission to the Endowment's broker of record. The Government simply refuses to put these factors together and attempts to avoid the logic of the evidence at trial by treating the Claims Court's findings as if they were unrelated, offhand conclusions. (Br. 31-40)

C. The Claims Court Properly Found That the Dividends Greatly Exceeded the Value of the Endowment's Services.

The Endowment performed *only* those services normally performed by a group policyholder either with or without the assistance of a third party administrator. (JA 91-92, 167-68, 200-01, 247-48, 440, 482-83)[10] The Claims Court recognized that these were "insurance-related services." (Pet. App. 27a, 40a)

Against this background, the Claims Court analyzed the Endowment's role with reference to the traditional players in an association group insurance relationship. The Endowment was not an insurer. New York Life and Mutual of Omaha performed that function; they handled medical underwriting, bore the risk that claims would exceed premiums and received their normal compensation for so doing. (Pet. App. 27a, 47a; JA 83, 215-16) The Endowment did not function as an insurance agent or broker. (Pet. App. 27a; JA 83, 87, 212-14) New York Life and Mutual of Omaha paid commissions *only* to the broker of record, James

[10] The Endowment is not unique among association group policyholders in dispensing with the services of a third party administrator. (JA 168, 185, 187, 201)

Group Service, Inc., and not to the Endowment. (JA 170, 212-14, 300-03)[11]

In July of 1981, James Group Service, Inc., a third party administrator which has served as the Endowment's broker, proposed to the Endowment that it perform *all* services performed by the paid staff of the Endowment in connection with the Endowment's insurance programs for an annual fee of $997,600, in addition to its brokerage commission of approximately $70,000. (JA 87, 312-13; CA App. 1173-84; JA 310-11) The proposal included a profit to James Group of approximately 25% and specifically reserved an opportunity to bid against any lower proposals, if the Endowment put the administration of the plan out for competitive bids. (JA 311-12)[12] The Government's expert economist conceded that in a competitive bidding situation a competitive bid by a third party administrator would include only a "miniscule profit." (JA 481)

The Government asserts that the Endowment is compensated for "exploit[ing] a very valuable, but vir-

[11] The Endowment could never have been qualified as an insurance company under Illinois law. *See, e.g.*, Ill. Rev. Stat., ch. 73, arts. II and III (1981) (Ill. Insurance Code §§ 6-60). Illinois law would have prohibited any payment to the Endowment for acting as an agent or broker or for organizing and bringing the group to the insurance companies. (Ill. Rev. Stat., ch. 73 § 1065.40 (1981) (Iil. Insurance Code § 493); JA 87)

[12] The James Group offer was not accepted, principally because the Endowment Board did not want to give up the format of a non-commercial program whereby a board of lawyers was responsible to the members for the administration of the program. The Endowment also did not want to become the captive of a third party administrator. (JA 296-97)

tually cost-free asset—a pool of potential insureds, all ABA members, who have far-above-average mortality and morbidity experience." (Br. 33-34) This is unsupported by the record. Both the insurance plan and the "market" were made available to the ABE by the ABA (JA 73-74, 118-23, 144-45), and cannot be considered a commercial creation of the ABE. The ABA mailing list is available for rent by insurance companies. The uncontradicted testimony is that the American Bar Association, not the ABE, owns the mailing list of ABA members, and that the entire list could have been rented by an insurance company for around $10,000 in 1981 (and less for prior years). (JA 88, 349-51) In fact, portions of the list were rented by insurance companies during the years in issue. (JA 351-53)

The record thus indisputably shows that the fair market value, including a handsome profit, of *all* services rendered by the Endowment during the years in issue does not exceed approximately $1,000,000. Nevertheless, the Government contends that the full amount of the dividends returned to the Endowment (ranging from $5.1 million to $6.8 million per year during the years in issue (JA 82)) was "compensation" for "services." The Claims Court found unequivocally that the Endowment received no compensation of any kind from either New York Life or Mutual of Omaha. (JA 508-09) Therefore, the Government must be asserting that the Endowment was paid "compensation" *by its insured members* of 40.1 to 49.4 percent of gross premiums during the years in issue, an amount that Chief Judge Kozinski found to be grossly in excess of the fair market value of ABE's insurance-related services. (Pet. App. 40a, 44a)

Not surprisingly, Chief Judge Kozinski rejected the contention that the Endowment members had "been subject to an epidemic of irrationality in permitting themselves to be bilked in this manner for almost three decades" by an organization they control. (Pet. App. 41a)[13] Instead, the Claims Court chose the "far more reasonable explanation" that the members allowed the Endowment to retain this money because they supported its charitable fundraising program. (Pet. App. 33a-41a)

The most strained effort by the Government to avoid the record is on the issue of whether the Endowment realized "profits" and the claim (Br. 33-36) that the "staggering amount of money consistently generated by the Endowment's activities" (Pet. App. 36a-37a) is in fact indicative of a trade or business rather than the charitable fundraising effort identified by the Claims Court and the Federal Circuit. At trial, the only entities associated with insurance that the Government could point to which in the past had made "profits" equivalent to those it attributes to the Endowment were issuers of credit insurance in loan transactions who had abused consumers and had to be regulated, title insurance organizations which in past years were acknowledged to be "quite abusive", and certain sponsors of group insurance plans which in past years were characterized as the "robber

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[13] Lawyers are hardly a captive market for the Endowment program. Their excellent mortality and morbidity ratings and high incomes make them prime targets for insurers. (JA 188-89) Almost 80% of the Endowment's members bought their insurance elsewhere. (JA 87) Many insured members, including all four of the individual respondents, utilized the Endowment plan for only a portion of their insurance. (JA 260, 272, 277, 282)

scoundrels" of the insurance industry. (JA 476-78) Chief Judge Kozinski rejected any suggestion that the elected leaders of the Bar, who managed the affairs of the Endowment in response to the wishes of its members, should be placed in the same category as "robber scoundrels." (Pet. App. 37a & n.6; JA 499-500)

D. The United States Offers No Basis For Setting Aside The Findings and Judgments of the Courts Below.

1. The Legislative History Supports the Holdings Below.

The Government misreads the legislative history of sections 501(c)(8), 501(c)(9), 501(c)(19) and 512(a)(4) expressly exempting from unrelated business income tax the provision by fraternal benefit organizations, voluntary employee benefit associations and veterans' groups, respectively, for the payment of life, sick, accident, or other benefits to members or their dependents. (Br. 19-22) Congress contemplated that either directly providing insurance to members or serving as a commission agent for insurance companies would be related to the exempt purposes of the enumerated organizations. (*Id.* 20-21) The legislative history of these sections of the Code is not relevant here. The Endowment does not contend that its group insurance program is substantially related to its exempt purposes. Moreover, the trial court has found that the excess of its dividends over related expenses is not derived from issuing insurance or providing services to anyone.

It should be noted that the Government's current proposition on the legislative history has never before been advanced in the long administrative and judicial history of this case, not even in 1972 and 1973 when the Service twice ruled in favor of the Endowment

despite the fact that the Congressional actions referred to were fresh. Why did the Government then take seven years to reverse its position, and six more years for this particular argument to surface? The answer is, of course, that the portions of the legislative history now relied upon by the Government have no relevance to the factual setting of this case. The legislative history pertinent to the fraternal, employee and veterans' groups does not indicate a Congressional intent to treat gifts to an organization like the Endowment as unrelated business income.

What is relevant to the Endowment's case is the legislative purpose of eliminating *unfair* competition.[14] The Endowment does not compete unfairly with anyone. It is telling that, despite the enormous amount of discovery conducted by the Government prior to trial, no person testified that the Endowment was competing unfairly with him or her and Chief Judge Kozinski was unable to identify anyone harmed by the Endowment's activities.[15]

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[14] The unrelated business income tax was enacted to eliminate *unfair* competition. (Pet. App. 6a n.2; S. Rep. No. 2375, 81st Cong., 2d Sess. 29 (1950)). *See also* H. Rep. No. 2319, 81st Cong., 2d Sess. 37 (1950); *Crosby Valve & Gage Co. v. Commissioner*, 380 F.2d 146, 148 (1st Cir.), *cert. denied*, 389 U.S. 976 (1967); Treas. Reg. § 1.513-1(b).

[15] "Now, nobody has really satisfactorily pointed to Ronzoni for me. I have been listening for three weeks of trial and nobody came up and said, 'Here, this is Ronzoni, this is the competitor that is going to be adversely affected in the manner in which Congress feared there would be adverse effects when it slapped Mueller Macaroni Company on the wrist, or basically said you cannot do that, you cannot use your tax exempt status to make profits." (JA 507)

2. The Trade Association Cases Are Not This Case.

The Government relies heavily on three cases involving trade associations,[16] arguing that those "cases are for all intents and purposes indistinguishable" from the Endowment's case (Br. 28) and ignoring the critical distinctions between those cases and the Endowment's case. The income of the trade associations was received in a commercial context in return for the performance of services, while here the revenues in question were found by the trial court to be derived not from services but from a group gift made by the membership in the context of a charitable fundraising program.

Each of the trade associations was paid a normal commercial fee by an insurance company for services rendered. The associations received percentages of premiums which were "well within the range normally paid for those types of promotional and administrative services, [and] stand in stark contrast to the 40, 50 and even 90% of premiums regularly refunded as dividends and retained by ABE." (Pet. App. 44a-45a)

The principal unrelated business income issue in *Professional Insurance Agents* concerned a percentage of premiums paid to PIA by insurance carriers for its activities in connection with several different group

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[16] *Professional Ins. Agents v. Commissioner*, 726 F.2d 1097 (6th Cir. 1984), *aff'g*, 78 T.C. 246 (1982); *Carolinas Farm & Power Equip. Dealers Ass'n v. United States*, 699 F.2d 167 (4th Cir. 1983), *rev'g*, 541 F. Supp. 86 (E.D.N.C. 1982); *Louisiana Credit Union League v. United States*, 693 F.2d 525 (5th Cir. 1982), *aff'g*, 501 F. Supp. 934 (E.D. La. 1980).

insurance programs that it endorsed.[17] It was undisputed that these payments were made by insurance carriers *in return for services rendered to them*. 726 F.2d at 1099, 1100.

In analyzing whether PIA was conducting a trade or business, the Sixth Circuit appropriately focused on the phrase "carried on for the production of income", since it was clear that the fees were derived from the performance of services. The court asked "whether PIA has engaged in extensive activity over a substantial period of time with intent to earn a profit." *Id.* at 1102. Since the record reflected a profit motive, the tax was imposed. In the Endowment's case, on the other hand, the Endowment proved that the monies it received did not come from the sale of goods or the performance of services. Both courts below found that the dollars flowed to the Endowment because the ABE membership wanted dividends to go to charity instead of tax-free to themselves, and not because its activity was carried on to earn a commercial profit from the sale of goods or the performance of services.

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[17] The Government claims that the trade associations received and retained dividends from insurance companies. (Br. 26) This statement is misleading. In one case a dividend was returned to the members, as is commonly the case in association group insurance. *See Carolinas Farm & Power Equip. Dealers Ass'n, supra*, 541 F. Supp. at 88. The only association that received *and retained* anything in addition to a flat percentage of premiums was PIA. PIA received an "experience rating reserve" when one of the programs it endorsed was terminated. Although PIA agreed to be responsible for distributing this fund to its members, it never did so and there is no indication that PIA members knew that PIA had received and retained this fund to which they were entitled. 726 F.2d at 1100-01.

The other cases, *Louisiana Credit Union League* and *Carolinas Farm & Power Equip. Dealers Ass'n*, are to the same effect. Normal commercial fees were received from insurance companies in the amount of $2^1/_2$ percent to $7^1/_2$ percent in *Louisiana Credit Union League, supra*, 501 F. Supp. at 936, and seven percent in *Carolinas Farm & Power Equip. Dealers Ass'n, supra*, 541 F. Supp. at 88. Both arose in the same commercial context found in *PIA*. Neither had any of the numerous features of the charitable fundraising program found in the Endowment's case.

The Government seeks to establish the relevance of the trade association cases by asserting that the common objective, here as in those cases, was "to earn a profit." (Br. 23-30) Following this reasoning (that is, to generate "profit" is the same as to generate revenue), it can be said that both General Motors and the United Way seek "to earn a profit." Yet the fundraising of United Way, even though accomplished by a large staff performing many functions, is obviously different from the profitmaking of General Motors. In the broadest sense every charity seeks to maximize the "profits" from its "fundraising";[18] but this does not mean that in every case "profit" indicates the existence of a trade or business or is the

[18] In his opinion, Chief Judge Kozinski used the term "fundraising" to refer to "charitable fundraising" as contrasted with a trade or business. *Cf. Disabled American Veterans v. United States, supra*, 650 F.2d at 1182-83 & n.8. The failure of the Government to appreciate this fact perhaps explains why it persists in raising arguments pertaining to destination of income (*e.g.*, Br. 33). The Endowment agrees that the destination of income test is not the statutory standard and has never argued to the contrary.

equivalent of income derived from the sale of goods or the performance of services.[19]

Neither the Claims Court's nor the Federal Circuit's decision stands for the proposition that the differences *per se* between a section 501(c)(3) organization and a section 501(c)(6) organization justify a different treatment for purposes of the unrelated business income tax. If the taxpayers in the cases discussed above had been section 501(c)(3) organizations, the result should have been the same. The difference in treatment in this case is justified by the radical differences in the *programs administered* by the Endowment and the trade associations there involved, not by the difference in the statutory source of the exemption of the organizations administering such programs. The statutory definition of a trade or business should be applied consistently to each exempt organization, and that is precisely what the Claims Court and the Federal Circuit did.

3. The Wholesale-Retail Analogy Is Inapposite

In an effort to avoid the Claims Court's finding that the Endowment receives sums "wholly unrelated" to any service it provides, the Government characterizes the Endowment's relationship with its insured members as "buying at wholesale, selling at retail, and rendering the ancillary services necessary to that sales operation." (Br. 25) Of course, the short

[19] The Government's expert economist testified that the maximization of revenue or profits "absolutely" did not provide a basis for distinguishing between charitable fundraising and business profits. Further inquiry was required to determine whether the funds derived were the product of a business or a charitable fundraising effort. (JA 457-58)

answer to the wholesale-retail argument is that the Court found otherwise (Pet. App. 27a, 47a), and Illinois law would not permit the Endowment to sell insurance.

The wholesale-retail argument illustrates the thrust of the Government's case at trial—that the Endowment's insurance program was something other than what it purported to be. It argued that ABE members did not really understand or support the program. It argued that the dividends were payments by New York Life and Mutual of Omaha for bringing the group to the insurance companies. It argued that the Endowment bought insurance wholesale and sold it retail. Rejecting all of these contentions, the Claims Court found that *the Endowment's program in fact was what it purported to be*—a charitable fundraising program in which a group joined together to support projects that they believed to be worthwhile. (JA 500-501) In short, the Government's position has no support in the record.

The Government argues that the Endowment "required members to waive their dividends" (Br. 25) and thereupon set gross premiums at a level competitive with other insurance on the market "so that the *entire amount* the members paid was a *premium* payment for *insurance*." (*Ibid.* Emphasis in original.) This argument ignores the nature of a dividend. *See supra*, pp. 21-23. It also ignores the fact that, if the Government's wholesale-retail argument were valid, the members of other professional association groups purchased insurance "wholesale." The ABE membership also could have "got it wholesale," but chose not to; the membership decided to assign their dividends to charity.

4. The Government's Fear of Tax Abuse Is Baseless.

Although this charitable insurance program of the ABA/ABE members has been highly visible for 28 years, the record does not reflect a single instance where other professionals have sought to duplicate it. The members of numerous professions have chosen instead to establish service-oriented insurance plans where excess premium dollars were returned to the members tax free. (*E.g.*, JA 144-45, 168, 175-76, 316, 326-27, 381-82, 407-08) ABA/ABE members who participated in the Endowment's insurance program similarly could have chosen to pocket more than $63 million over the last 25 years (Pet. App. 32a), with no tax liability to themselves. It is hard to suppress skepticism at the Government's unsupported contention that hordes of members of tax-exempt organizations are now prepared to follow the practice of the members of the Endowment and remove from their pockets tens of millions of dollars they have historically kept in order to donate that money for charitable uses. But if the members of these other organizations should decide to dedicate to charitable uses in their respective fields monies that have been going into their own pockets, this should be welcomed, not deplored.

No "loophole" is created by a charitable fundraising program reflecting the wishes and generosity of members, undertaken at a substantial out-of-pocket cost to them. A business group or tax-exempt organization could develop a plan under which a payment is made to secure an economic benefit and in addition make a substantial contribution to charity. *See infra*, Part II.B. There is nothing novel in the concept. Charity dinners, concerts and dances have long been recog-

nized as valid means of charitable fundraising. The Endowment's plan merely applies this concept under the unique circumstances of professional association group insurance.

II. The Federal Circuit Was Correct In Holding That Individual Insured Members Should Have The Opportunity Of Proving That They Participated In The Group Gift By Assigning Their Proportionate Share Of Dividends To The Endowment For Charitable Purposes.

A. Introduction

The individual taxpayers asked the Claims Court to hold that all insured members of the Endowment were entitled to a charitable contribution deduction on the ground that they knowingly participated in a program in which premiums paid for insurance coverage were intended by the members to be a "dual payment," part for insurance protection and part for charity. The Claims Court declined to so hold, instead concluding that a deduction would be available only if the individual insured could show charitable motivation by proving that an equivalent insurance product was available to him for a lower price and he bypassed that product in order to make a contribution to the Endowment. (Pet. App. 52a; JA 522)

Although the Federal Circuit likewise declined to accept the uniform rule, it nevertheless rejected "the [lower] court's particular method of determining charitable motive" by adopting a "unitary approach". (Pet. App. 15a)[20] The Federal Circuit held that "[t]his de-

[20] Among the deficiencies of the trial court's test is that under it those with the greatest charitable motivation to participate in the Endowment's program would be the least likely to have done the difficult comparison shopping required by the test. Judge Kozinski himself recognized the difficulties of his approach. (JA 522)

termination [of charitable motive and intent] must flow from an examination of all the pertinent circumstances surrounding the individual transaction—there is no single-factor test." (Pet. App. 15a, 21a) Consequently, it remanded for "such further proceedings as are appropriate to determine whether the relationship between the Endowment and the taxpayers was predominantly of a business nature or whether the transaction did have a substantial charitable component." (Pet. App. 22a-23a)

B. All Parties Recognize the Dual Payment Concept.

A taxpayer is entitled to a deduction for "any charitable contribution," defined simply as a "contribution or gift" made during the taxable year to or for the use of a qualifying organization. I.R.C. § 170(a) and (c). The deductibility of charitable contributions is a liberalization of the law in the taxpayer's favor, "begotten from motives of public policy, and [is] not to be narrowly construed." *Helvering v. Bliss*, 293 U.S. 144, 151 (1934). It is true that a transfer to a charity is not a contribution if the transferor receives, or expects to receive, *commensurate* economic benefits in return (Br. 40-42), just as it is true that, as a "corollary of this rule" (Br. 42), a taxpayer's payment to a charity may be tax deductible where he receives in return a benefit that is *not commensurate* with the amount of his transfer.[21] In order to establish a dual payment, "the taxpayer must prove that the amount

[21] As the Government puts it, "[s]uch a 'dual payment' is treated as in part a purchase of goods or services, and in part a charitable contribution." (*Ibid.*)

he paid to the charity exceeded the fair market value of the consideration that he received in return" (Br. 42), and that this excess amount was paid "with the intention of making a charitable contribution." (Br. 43)

In the instant case, each insured member's premium payment to the Endowment was a dual payment in that it was "quite clear that the payments that [the insured members] actually made were, in fact, partially used to buy insurance, and partially by way of the dividends then used to support the charitable purposes of the Endowment." (JA 533) The Federal Circuit remanded only to inquire into whether the member was motivated in part by charitable instincts in making his payments. (Pet. App. 21a-23a)

C. The Insured Members Made a Dual Payment.

The Government asserts that the insured members received insurance coverage worth the initial premium paid by each member. However, fair market value "is the price at which [this insurance] would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of the relevant facts." Treas. Reg. § 1.170A-1(c)(2). As the Government concedes, fair market value is determined "in the 'usual market' in which it is sold." (Br. 42) In other words, *the fair market value is measured objectively by the market price for professional association group insurance which the group would have paid absent the charitable program.*

There can be no question about the fair market value of the association group insurance coverage. New York Life and Mutual of Omaha would have

welcomed the opportunity to write the Endowment's plans in the same way as other professional association plans—with the dividends used for the economic benefit of the members. (JA 160 ("Quite eagerly."); JA 218 ("Yes, we would do that.")) If reasoned concepts of valuation are applied—what the insurance would cost without the charitable feature—the answer is that the fair market value of the insurance received by the members is precisely what the *insurance component* of the dual payment cost the insured members. Thus, while the value of services rendered *by* the Endowment is the only proper measure of the *quid pro quo* received by ABE members *from* the Endowment, one arrives at the same place if the group insurance is treated as the *quid pro quo*.

The Government, turning away from the most direct evidence of the cost to lawyers of similar coverage (the New York Bar plan discussed *supra*, pp. 11-12 n.7),[22] seeks to value participation in the ABE group insurance plan by reference to what it would have cost the insureds to secure a comparable amount of insurance under a wide range of individual policies or other plans. The Government has failed to recognize that, for tax purposes, the fair market value of participation in a group insurance program is *never* determined by reference to what it would have cost each insured to leave the group and buy other insurance, whether individually or through another group. *See* I.R.C. § 61 and Treas. Reg. § 1.61-2(d) (the fair market value of an interest in a group term

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[22] Even though the New York Bar offers a very inexpensive group life insurance plan, the largest enrollment of any state in the Endowment's much more costly plan was in New York. (JA 183)

policy is determined by reference to the *employer's* allocable cost of the policy, *i.e.*, what the employer actually paid for it). *See also* Rev. Rul. 76-490, 1976-2 C.B. 300.[23] This rule of valuation certainly should be followed for a voluntary membership group where the members are fully advised about the program and control it.

D. Requiring a Contribution as a Condition of Participating in the Endowment's Plan Does Not Negate Recognition of the Contribution.

The Government rests its case on both the unrelated business income and charitable contribution issues on the ground that the Endowment does not each year offer its members the option of receiving their share of the dividends. (Br. 25, 37) However, the Internal Revenue Service has long recognized that the requirement of a charitable contribution as a condition to obtaining some goods or services does not negate recognition of the charitable contribution to the extent the payment exceeds the value of the goods or services obtained. This concept was expressly recognized by the United States Court of Claims in *DAV*, *supra*. There, both parties agreed that in computing any unrelated business income, the gross income should be based on the fair market value of the pre-

[23] In Rev. Rul. 84-147, 1984-2 C.B. 201, the Internal Revenue Service held that an employee may value a gift arising from the assignment of a group term life insurance policy by reference to "the actual cost allocable to the employee's insurance by obtaining the necessary information from the employer." The Government should simply apply Rev. Rul. 84-147. *See generally, Enright v. Commissioner*, 56 T.C. 1261 (1971); *Estate of Worster v. Commissioner*, 47 T.C.M. (CCH) 1266 (1984); *N.W.D. Investment Co. v. Commissioner*, 44 T.C.M. (CCH) 1246 (1982); Rev. Rul. 76-490, 1976-2 C.B. 300.

miums (*i.e.*, goods) received, "and not on the contribution level which DAV *set as a requirement to obtain the premium.*" 650 F.2d at 1190. (Emphasis added.) Likewise, there is no suggestion in Rev. Rul. 67-246, 1967-2 C.B. 104, that the deduction should be disallowed where the "donor" at a charitable event would gladly have paid the full amount charged for the opportunity provided to socialize with a prospective customer, to be seen with a particular social group, or to hear the only performance being given in the city by the taxpayer's favorite pianist. Indeed, requiring a contribution is the essence of the success of a variety of fundraising events. The knowledge that each participant is paying something extra to eat rubber chicken or listen to a concert encourages others to give. The logical result of the Government's argument is that the premium paid for the charity performance is unrelated business income if the extra payment is not optional. Such a result would deal a stinging blow to charities that depend on fundraising events for their support.

E. The Federal Circuit's Decision Is Consistent With Established Principles of Tax Law.

The Government also appears to claim that the individual insureds' cases are in conflict with *Sedam v. United States*, 518 F.2d 242 (7th Cir. 1975); *Stubbs v. United States*, 428 F.2d 885 (9th Cir. 1970), *cert. denied*, 400 U.S. 1009 (1971); and *Singer Co. v. United States*, 449 F.2d 413 (Ct. Cl. 1971). A proper analysis of these cases, however, shows that the Federal Circuit's decision is consistent with each.

In *Sedam*, the taxpayer claimed a charitable deduction for payments made "in consideration" for a nursing home admitting his mother as a resident. 518

F.2d at 245. The court stated that "a payment is not a contribution or gift under section 170 if it is made with the expectation of receiving a *commensurate* benefit in return . . . ." *Id.* (Emphasis added.) There was no contention by the taxpayer that a dual payment was made. He had deducted the entire payment. The Federal Circuit applied the same standard in this case (Pet. App. 13a-15a) as the Seventh Circuit did in *Sedam*. The differing facts dictated different outcomes.

The suggestion that *Singer Co.* conflicts with the Federal Circuit's opinion is somewhat surprising in view of the fact that the Federal Circuit *relied* upon *Singer*. (Pet. App. 15a-18a) In *Singer*, the taxpayer expected that sales of sewing machines to schools at less than market prices would increase future retail sales. A deduction was denied because the taxpayer failed to show that the fair market value of the anticipated economic benefit was less than the discount given to the schools. 449 F.2d at 420, 423-24.

Stubbs was a jury case in which the question was whether a landowner could deduct as a charitable contribution the value of land dedicated as a public road. The issue of a *quid pro quo* was put to the jury, which apparently believed the prior inconsistent testimony of the taxpayer at a hearing before the Zoning Commission that he would receive an offsetting economic benefit to an adjacent property by reason of the transfer. 428 F.2d at 887 n.1. As in *Sedam*, there was no contention that there was a dual payment.

Finally, the Government erroneously argues (Br. 45) that the Federal Circuit decision has in some way altered traditional principles of burden of proof applicable in tax refund cases by stating that that burden would shift to the Government on the deductibility issue upon presentation of a *prima facie* case. In fact, the Federal Circuit applied well-recognized concepts of shifting evidentiary responsibilities at trial to the particular circumstances of this case. It outlined those elements which for certain members, taking all facts into consideration, would constitute a *prima facie* case for sustaining the charitable contribution deduction, while outlining other elements as to which a "trial court might reasonably conclude" that "the taxpayer should be denied a deduction." (Pet. App. 21a-22a) A *prima facie* case, of course, is that minimum quantum and quality of proof which, if unrebutted, would entitle the proponent to a judgment on his claim. Once the taxpayer has presented a *prima facie* case, it is only the burden of going forward with additional evidence to rebut that case which shifts to the Government. If the Government discharges its responsibility of coming forward with rebuttal proof, the taxpayer is still required to establish by a preponderance of the evidence his entitlement to the claimed deduction. This process is all that the Federal Circuit decision envisions, and nothing in its opinion offends any notion regarding the burden of persuasion in tax or other civil cases.

CONCLUSION

The judgment of the Federal Circuit should be affirmed.

Respectfully submitted,

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